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Order 96-5-38

UNITED STATES OF AMERICA
DEPARTMENT OF TRANSPORTATION
OFFICE OF THE SECRETARY
WASHINGTON, D.C.

SERVED: May 29, 1996

Issued by the Department of Transportation
on the 28th day of May, 1996

Joint Application of

AMERICAN AIRLINES, INC. and
EXECUTIVE AIRLINES, INC., FLAGSHIP AIRLINES, INC., SIMMONS AIRLINES, INC., and WINGS WEST AIRLINES, INC.
(d/b/a AMERICAN EAGLE)
and
CANADIAN AIRLINES INTERNATIONAL LTD., and ONTARIO EXPRESS LTD. and TIME AIR INC.
(d/b/a CANADIAN REGIONAL) and INTER-CANADIAN (1991) INC.

under 49 USC §§ 41308 and 41309 for approval of and antitrust immunity for commercial alliance agreement

Docket OST-95-792 – 26

ORDER TO SHOW CAUSE

American Airlines, Inc. and its regional commuter affiliates ("American"), and Canadian Airlines International, Ltd. and its regional affiliates ("CAI") have applied for approval and antitrust immunity under 49 U.S.C. §§ 41308 and 41309, for a Commercial Alliance Agreement ("the Alliance Agreement"), whereby the Joint Applicants will plan and coordinate service over their respective route networks as if there had been an operational merger between the two airlines.

We have tentatively decided to grant approval of and antitrust immunity for the Alliance Agreement between American and CAI. We have, however, tentatively found it appropriate to condition our approval as more fully explained below. We propose to withhold antitrust immunity with respect to services relating to fares and capacity for particular categories of U.S. point-of-sale local passengers in the New York-Toronto market, as agreed between the applicants and the Department of Justice ("DOJ"), until February 24, 1998, when bilateral restrictions will no longer impede full freedom of entry into U.S.-Toronto markets. We further propose to exclude from our approval and grant of antitrust immunity in this proceeding cooperative arrangements involving all-cargo services and services to third

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countries.[1] We propose to direct the applicants to file all subsidiary and/or subsequent agreement(s) with the Department for prior approval and to resubmit for renewal their various alliance agreement(s) in five years. We also tentatively find it in the public interest to direct CAI to report full-itinerary Origin-Destination Survey of Airline Passenger Traffic (O&D Survey) data for all passengers to and from the United States (similar to the O&D data already reported by American). By this order, we are providing the Joint Applicants and other interested parties the opportunity to comment on our tentative findings.

We tentatively find that, subject to the conditions and limitations specified, our action in this matter will advance important public benefits. Approval would permit the two airlines to operate more efficiently and to provide better service to the U.S. traveling and shipping public, and would allow American to compete more effectively with other carriers and alliances in U.S.-Canada transborder markets. With our proposed limitation of approval and immunity to these transborder markets, our proposed action will be consistent with our policy of facilitating competition among emerging multinational airline networks, where those networks will lead to lower costs and enhanced service for U.S. and international consumers. We fully recognize that the trend toward expanding international airline networks and our action here will allow our airlines to become significant players in the globalization of the airline industry.

Our proposed action in this order, as limited to U.S.-Canada transborder markets, is consistent with our approval and grant of antitrust immunity for the alliance between Northwest Airlines and KLM,[2] and with our recent grant of immunity for the proposed alliance between United Air Lines and Lufthansa.[3] Our experience with the Northwest/KLM alliance has demonstrated that such alliances between U.S. and foreign airlines can benefit consumers. The alliance between Northwest and KLM has enabled the two airlines to operate more efficiently and to provide integrated service in many more markets than either partner could serve individually.[4] We expect that the alliance between American and CAI will also provide substantial benefits to consumers.

I. Background

A. The U.S.-Canada Aviation Agreement

On February 24, 1995, the Governments of the United States and Canada signed a new Air Transport Agreement Between the Government of Canada and the Government of the United States. The new accord allows any Canadian carrier to serve any point in the United States, effective immediately. It also allows U.S. carriers to serve any point in Canada *except* (in the short term) Montreal, Toronto, and

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[1] The predicate for our tentative approval and grant of antitrust immunity for the American-CAI alliance is the existence of a bilateral aviation agreement between the United States and Canada that provides for open transborder (*i.e.*, third- and fourth-freedom) markets, subject to a short-term phase-in period. To the extent that the U.S.-Canada market remains restricted beyond the phase-in period provided for in the U.S.-Canada agreement, we are unprepared to grant antitrust immunity. However, this Department would consider lifting these restrictions on grant of antitrust immunity if and when the underlying market restrictions are removed.

[2] Orders 93-1-11 and 92-11-27.

[3] Order 96-5-27, May 20, 1996.

[4] *International Aviation: Airline Alliances Produce Benefits, but Effect on Competition is Uncertain* (GAO/RCED-95-99, April 6, 1995); and *A Study of International Airline Code Sharing*, Gellman Research Associates, Inc., December 1994.

Vancouver, effective immediately. It does provide soon, however, for open entry by U.S. carriers into the three restricted Canadian cities, to be phased in over two years (at Montreal and Vancouver) and three years (at Toronto). At Vancouver and Montreal, during each of the first two years from the date of the agreement, the U.S. is able to designate six additional carriers, with each carrier able to operate up to two daily round-trip frequencies. At Toronto, during each of the first two years from the date of the agreement, the U.S. is able to select up to two additional carriers, with each carrier able to operate up to two daily round-trip frequencies. For the third year, the U.S. is able to select up to four more carriers, each with up to two daily round-trip frequencies. U.S. carriers will gain open entry at Montreal and Vancouver effective February 24, 1997, and at Toronto effective February 24, 1998. The agreement also places frequency limits on code-sharing operations between the United States and Montreal, Vancouver, and Toronto. These limitations also expire February 24, 1997, at Montreal and Vancouver, and February 24, 1998, at Toronto.

The purpose of the new U.S.-Canada agreement is to create an open transborder aviation environment between the U.S. and Canada. U.S. carrier entry is temporarily restricted at the three largest Canadian gateways to give the national carriers of Canada time to adjust to the new competitive environment. As the earlier U.S.-Netherlands Agreement has demonstrated, open transborder operations should encourage more competitive service in U.S.-Canada transborder markets. Since the price and service quality of U.S.-Canada transborder airline service will be disciplined by market forces, not restrictive bilateral agreements, U.S.-Canada travelers will have multiple price and service options in choosing airline services available on transborder routes between the United States and Canada.

B. The Joint Applicants' Operational and Ownership Relationships

American and CAI began coordinating parts of their operations before the signing of the new air services agreement. In 1994, American's parent corporation AMR acquired a one-third equity interest in CAI in return for a cash investment of $182 million (US). In addition, AMR provides the following services under contract to CAI, and under CAI's managerial control: pricing and yield management, operations planning, international base operations, food and beverage support, reservations, ground operations, capacity planning, technical and data processing services, and accounting services. The contract provides for payment by CAI to AMR of $2 billion over 20 years.

The applicants offer competing nonstop services with their own aircraft in the following two markets:

Chicago (O'Hare)-Toronto: Operated 6 times daily by American and 2 times daily by CAI.
New York (La Guardia)-Toronto: Operated 7 times daily by American and 5 times daily by CAI.

The Joint Applicants also currently operate code-sharing services in the following nine nonstop markets:

Chicago (O'Hare)-Calgary: Operated 2 times daily by American.
Chicago (O-Hare)-Montreal: Operated 5 times daily by American.
Chicago (O'Hare)-Ottawa: Operated 2 times daily by American.
Chicago (O'Hare)-Winnipeg: Operated 2 times daily by American.
Dallas/Ft. Worth-Calgary: Operated 3 times daily by American.
Dallas/Ft. Worth-Toronto: Operated 3 times daily by American.

Honolulu-Vancouver: Operated 5 days a week by CAI.
Miami-Montreal: Operated daily by American.
Miami-Toronto: Operated 3 times daily by American.

In addition, they offer joint code-sharing service in the two nonstop markets where they directly compete. They also operate single-plane and connecting code-sharing service between (1) numerous interior (non-gateway) U.S. cities (American) and numerous interior (non-gateway) cities in Canada (CAI); (2) between several U.S. cities, on the one hand, and Taiwan and Hong Kong, on the other, via Vancouver (CAI); and between Montreal/Ottawa/Winnipeg and Manchester and Birmingham, UK, via Chicago (American).[5]

The Joint Applicants' current code-sharing agreement provides for the coordination of schedules, reservation systems, marketing and distribution, and frequent flyer programs over the code-sharing routes. However, each airline independently establishes its fares and rates for flights offered to the public under its airline designator code. As a consequence, the Joint Applicants engage in price competition over these code-sharing routes.

II. The American and CAI Commercial Alliance Agreement

The Commercial Alliance Agreement creates a contractual framework for future comprehensive systemwide collaboration and coordination by the applicants. To create a global alliance providing seamless air transportation services, the Agreement provides, subject to negotiation and execution of subsidiary agreements, for the establishment of joint scheduling, marketing, pricing, planning, joint services, and related matters. Specifically, the Agreement calls for the negotiation or creation of the following joint products:

(1) quality and service standards (including inflight and ground services and amenities);
(2) operating committees to oversee project development, budgets, and other activities;
(3) service contracts, to ensure consistency of product and service, and to avoid redundancies;
(4) schedule coordination, including third-party marketing, network planning, and information systems;
(5) passenger and cargo pricing and sales strategies, including inventory management, program discounts, wholesale and corporate discount programs, and airline prorates;
(6) common sales staff to market the products and services of both carriers;
(7) commission programs, including agency, group, corporate, and override commissions;
(8) travel agent contracts;
(9) advertising and media programs;
(10) ancillary programs, including travel packages, facilities coordination, information systems, and mail service;
(11) coordinated frequent flyer programs;
(12) revenue allocation agreements and procedures;
(13) common marketing and accounting information; and
(14) creation of a joint identity through jointly developed logos, symbols, or names.

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[5] American is not authorized under the bilateral to provide Vancouver-Taiwan/Hong Kong service, and CAI is not authorized to provide Chicago-Manchester/Birmingham service. In both instances, a change in flight number is required for sixth-freedom operations to third countries.

In short, the Alliance Agreement, if approved, will allow the two airlines effectively to operate much as a single firm, while retaining their individual identities regarding national ownership and control.

III. The Application and Responsive Pleadings

A. The Joint Applicants' Request[6]

On November 3, 1995, American and CAI filed a request seeking approval of and antitrust immunity for the Commercial Alliance Agreement, for a five-year term. In addition, the Joint Applicants also request antitrust immunity for the coordination of the presentation and sale of the carriers' airline service in their computer reservation systems (CRS) and the operations of their respective internal reservations systems.[7]

The Joint Applicants state that, through their Alliance Agreement, they intend to broaden and deepen their cooperation in order to improve the efficiency of their coordinated services, expand the benefits available to the traveling and shipping public, and enhance their ability to compete in the global marketplace. Although the Joint Applicants state that they will continue to be independent companies, they claim that the objective of the Alliance Agreement is to enable the airlines to plan and coordinate service over their respective route networks as if there had been an operational merger between the two companies.

The applicants assert that approval of and antitrust immunity for the Alliance Agreement is supported by substantial public and commercial benefits and efficiencies and by U.S. international aviation policy. They state that the alliance will create network synergies by (1) linking the U.S. and Canadian hubs of the alliance partners; (2) producing cost efficiencies and savings through integration and coordination that can be passed on to consumers in the form of lower fares and improved service (including increased frequencies); and (3) increasing competition in the U.S.-Canada and the global marketplaces. Conversely, they argue that denial of their requests will prevent consummation of the Alliance Agreement and thereby deny the benefits to the public. The Joint Applicants state that they cannot carry out the complete

> integration contemplated by the . . . Agreement in the absence of antitrust immunity because of the substantial risk . . . [of] costly and lengthy antitrust litigation . . . . This very real threat of a challenge would chill the alliance and reduce its benefits to the traveling and shipping public.[8]

Therefore, the airlines regard antitrust immunity as an essential condition precedent to implementation of the Alliance Agreement.

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[6] By Order 96-1-6, issued January 11, 1996, we found that the record of this case was substantially complete, and established further procedural deadlines. We also deferred action on the Joint Applicants' motions for confidential treatment of certain data and documents (these motions were filed by American on February 29 and CAI on March 11, 1996), while limiting access to the information to counsel and outside experts who represent interested parties in this case.

[7] American is the principal owner of SABRE, and CAI participates in SABRE. In addition, American's parent corporation, AMR, operates CAI's internal reservations system under contract to CAI.

[8] Joint Application, at 48-49.

The applicants maintain that neither carrier can attain these public interest benefits, either individually, due to existing bilateral barriers and financial constraints, or through merger, because U.S. and Canadian laws concerning nationality and ownership effectively preclude mergers between U.S. and Canadian airlines.[9] Therefore, in the absence of a merger, the joint venture planned by the Alliance Agreement requires that the applicants craft business understandings that will expose them to the risk that their coordinated activities would be challenged on antitrust grounds. The Joint Applicants state that the Alliance Agreement will permit them to compete more effectively against competing global alliances. They further maintain that the Alliance Agreement will allow them to develop mechanisms to enhance efficiencies, reduce costs and provide better service to the traveling and shipping public by providing for: increased frequencies and enhanced on-line services; expanded access to beyond and behind gateway markets; coordinated hubs and U.S.-Canada segment operations; expansion of discount fares; enhanced availability of discount seats on transborder flights; improved seat inventory control; and reduced sales, marketing and reservations costs.

The Joint Applicants also maintain that the grant of antitrust immunity will advance U.S. international aviation policy objectives by accelerating liberalization of the global marketplace, thus achieving an important goal of the Department's "Open Skies" initiative. Further, the applicants assert that the Alliance Agreement is fully consistent with the Department's policy of encouraging and facilitating the globalization and cross-networking of air transportation. They maintain that approval of the proposed Alliance Agreement, coupled with antitrust immunity, will foster real economic and competitive pressures in the marketplace that will accelerate reform and transform international aviation policy.[10]

The applicants hold the view that their request is warranted by foreign policy considerations, fully consistent with U.S. international aviation policy, and an envisioned outcome of the new aviation arrangement between Canada and the United States. American and CAI contend that denial of the request for antitrust immunity might well discourage other foreign governments from negotiating Open Skies accords with the United States. The applicants assert that denial of their request for antitrust immunity would be inconsistent with the U.S. Government's commitment to open-entry markets and free and fair international competition and to what they contend is the Department's assurance of comparable opportunities in exchange for open skies. They also claim that denial of immunity "would be contrary to the spirit of the North America Free Trade Agreement, the liberalized aviation agreement with Canada, and the expectations of the Canadian Government . . . ."[11]

The Joint Applicants assert that the Alliance Agreement will not substantially reduce or eliminate competition between the United States and Canada. Indeed, they argue that a fully implemented Alliance Agreement will enable American and CAI to increase their competitiveness against Air Canada, the largest U.S.-Canada carrier, and against Air Canada's U.S. code-sharing partners, Continental and United. They also claim that the proposed alliance will have substantially less effect on competition in the overall U.S.-Canada market than did the Northwest/KLM alliance on the U.S.-Netherlands market.

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[9] The Joint Applicants maintain that if U.S. and Canadian law permitted the two airlines to merge, their merger would comply with U.S. antitrust law. Since, the applicants assert, the proposed business relationship would essentially be an end-to-end market extension merger, it would have a nominal impact on horizontal competition. (Joint Application at 9.)

[10] Joint Application, at 7-8.

[11] Joint Application, at 30.

Similarly, American and CAI maintain that the alliance will not substantially reduce or eliminate competition in any single city-pair market. The applicants compete head-to-head in only two nonstop markets, Chicago-Toronto and New York-Toronto. In the Chicago-Toronto market, United, the largest hubbing carrier at Chicago, will continue to provide daily competitive service, while, in the New York/Newark-Toronto market, Air Canada, the largest U.S.-Canada carrier, will remain the dominant carrier in the market. As a consequence, the applicants argue that the competitive effects of the alliance will be even smaller than those the Department found with respect to the U.S.-Netherlands market when it approved the Northwest and KLM joint venture, where there was no third-carrier nonstop competition in the Minneapolis/St. Paul-Amsterdam and Detroit-Amsterdam markets. Further, the applicants claim that the liberalized aviation agreement between the U.S. and Canada will assure competitive discipline by providing for open entry and pricing and service freedom. They also maintain that almost all significant transborder city-pair routes--including the two nonstop routes where they compete with their own aircraft--are or can be served by multiple U.S. and/or Canadian airlines on either a nonstop, single-plane, or one-stop on-line connecting basis.

Finally, the applicants claim that, because the proposed alliance would have less impact on competition than did the Northwest/KLM alliance, approval of the agreement and grant of antitrust immunity are required to permit them to compete on a level playing field. In particular, they assert that approval and immunity are consistent with the Department's International Policy Statement, and that "the Department should not perpetuate a two-class system where only one alliance enjoys unique antitrust treatment not available to other alliances involving carriers from countries with liberalized regimes."[12]

B. Responsive Pleadings

Answers to the joint application were filed February 5 and 6, 1996, by Delta Air Lines, Northwest Airlines, United Air Lines, Air Canada, and the International Air Transport Association ("IATA").

Delta argued that the Department should either defer or dismiss the application for consideration at such time as the transitional restrictions under the U.S.-Canada bilateral expire. Since the full open-skies provisions of the U.S.-Canada bilateral will not take effect until February 25, 1998, Delta claims that there is no reason now for the Department to expend its limited resources on a matter that cannot and should not in any event be implemented for at least another two years.

Delta believes that there are two important reasons for an open-skies precondition: (1) the existence of an open-skies accord ensures competitive discipline by allowing U.S. carriers to serve those countries from any point in the United States and behind; and (2) it would further U.S. international aviation policy by encouraging expansion of liberal bilateral relationships between the United States and other countries. Thus, antitrust immunity encourages the development of other similar alliances between U.S. and foreign airlines and serves as an important inducement to other countries to liberalize their aviation regimes.

According to Delta, if the Department were to consider the grant of antitrust immunity for an alliance involving a foreign carrier whose government retains significant limitations on U.S. carrier entry, the

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[12] Joint Application, at 26.

Department would be "turning its international aviation policy on its head and sending foreign governments precisely the wrong message."[13]

Northwest also argues that the application should be denied now or at least deferred until such time as the United States and Canada have entered into a "true" open-skies agreement. According to Northwest, it is the Department's longstanding policy to consider antitrust immunity for cooperative marketing alliances only in circumstances where an open-skies aviation agreement is in place. Since the U.S.-Canada bilateral lacks many of the essential characteristics of an open-skies regime, Northwest believes that approval of this request would be anticompetitive and would "eviscerate the very fabric of the Department's 1995 International Policy Statement."[14]

Similarly, United believes that the application is premature and should be dismissed. United asserts that the U.S.-Canada aviation agreement restricts the right of U.S. carriers to initiate transborder services to Montreal, Vancouver, and Toronto, and that the grant of antitrust immunity to the Joint Applicants would be the equivalent of granting immunity to an alliance between a U.S. and U.K. carrier. While the transborder market remains subject to significant entry limitations, according to United, the Department has no assurance that a decision to grant antitrust immunity to this alliance would be pro-consumer and pro-competitive. Finally, United asks that, if the Department decides not to dismiss the application, it should set a procedural timetable for the filing of other applications for approval and antitrust immunity.

Likewise, Air Canada believes that it would be inappropriate to confer antitrust immunity upon alliances serving the transborder market on a discriminatory and selective basis, and especially during the pendency of the transition periods provided for in the U.S.-Canada Agreement. Thus, Air Canada believes that approving the joint application would cause severe competitive distortion in the transborder market.

IATA takes no position on the application's merits. IATA claims, however, that the Department should not consider the issue of whether to place restrictions on the Joint Applicants' participation in IATA tariff conferences. According to IATA, any such limitations on the Joint Applicants' participation in IATA traffic conferences as a condition for grant of antitrust immunity would be unfair to IATA, its members, and their governments.

The Joint Applicants filed a joint reply to the answers of Delta, Northwest, United, and IATA. They claim that the U.S.-Canada agreement has all the critical attributes of an open-skies accord, and has produced the most competitive international market in the world. The applicants point out that the Agreement provides for immediate entry on all routes (subject to the phase-in provisions) for U.S. carriers and complete pricing freedom for U.S. carriers.

The Joint Applicants further assert that, in judging applications for immunity, the Department should, contrary to the objectors' arguments, consider substance over form. The result of the U.S.-Canada accord is the creation of a genuinely competitive market. The transborder market is far more competitive than any of the four country-pair markets in which Delta and Northwest have formed alliances, and is far more likely to promote significant new service by non-alliance carriers. The

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13 Consolidated Answer of Delta, at 4.

14 Answer of Northwest, at 5.

applicants assert that the transborder market is fiercely competitive today, and new services are being added by the carriers of both countries.

According to the Joint Applicants, an open-skies accord is but one factor to be considered by the Department in assessing immunity applications. They claim that it has been the Department's policy to deny antitrust immunity for agreements that do not violate the antitrust laws unless immunity is required by the public interest and the parties will not proceed without it. The relevant statutory test, 49 USC section 41308, makes no mention of an open-skies condition. Further, they contend that the Department's Policy on International Aviation does not establish open skies as a precondition for immunity. According to the Joint Applicants, the U.S. Government did not present open skies as an essential precursor for immunity in last year's U.S.-Canada bilateral negotiations.

The applicants assert that an examination of public benefits requires weighing the pro-competitive benefits against potential anticompetitive harm, and includes the consideration of foreign policy objectives. The applicants assert that any agreement must be considered in the context of the relevant market structure to understand its impact on competition. They argue that the U.S.-Canada arrangement will be substantially pro-competitive, particularly when contrasted against the market structures in Europe. Simply, the transborder market is the most competitive international market in the world, and there is no relevant market in which the immunized alliance could substantially reduce competition and increase their market power.

In addition, the applicants state that approval of the request may encourage other countries to enter into similar aviation agreements, which would be a positive achievement for U.S. aviation policy. Contrary to Northwest's comments that immunizing the alliance would "eviscerate" the Department's 1995 International Policy Statement, the applicants believe that many countries simply will not be able to make an "overnight switch" from a restrictive regime to fully open skies, and that the phase-in period in the U.S.-Canada arrangement promotes the U.S. Government's goal of achieving open skies with these countries. The applicants state that "[a]n agreement which achieves the goal of open skies in a fixed period is just as deserving of the benefits of immunity as an immediate open-skies agreement, so long as the other tests for immunity are met."[15]

Finally, the applicants claim that the issues raised by IATA are not relevant in this proceeding. The applicants state that U.S.-Canada markets have never been included in IATA tariff coordination activities. Moreover, American withdrew from the IATA passenger tariff coordinating conference in 1994. Therefore, the Department's actions in this case will have no impact on IATA activities with respect to the transborder market.

IV. Tentative Decision

We tentatively find that the Alliance Agreement should be approved and granted antitrust immunity under sections 41308 and 41309, to the extent provided below. We have also tentatively decided to grant the Joint Applicants' request for antitrust immunity to coordinate their CRS and internal reservations system. CAI has no ownership interest in any CRS. Unlike the foreign airline partners in certain previous alliances, CAI has no ownership interest in a CRS competing with American's SABRE CRS. Accordingly, we find there is no need to impose conditions or otherwise limit immunity with

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[15] Joint Reply of American and CAI, at 26.

respect to the applicants' CRS operations. Our examination of the Joint Applicants' proposal tentatively leads us to find that the integration of the two carriers' services will enhance competition overall and allow the airlines to provide better service and enable them to operate more efficiently. We find that it is unlikely that the Alliance Agreement, subject to the conditions agreed upon by the applicants and the Department of Justice (DOJ), will substantially reduce competition in any market. Finally, our approval and grant of antitrust immunity for the proposed Alliance Agreement will allow the Joint Applicants to maximize, in the U.S.-Canada transborder markets, the various pro-competitive and pro-consumer benefits that we foresaw resulting from the fundamental liberalization of air services fostered by an open aviation accord.

As a threshold matter, we are prepared to go forward in the absence of full, open-skies provisions only because the U.S.-Canada market presents unique circumstances that justify special consideration. The U.S.-Canada relationship is *sui generis*. The two countries share the longest border in the world. The vast majority of Canadians live within an hour's flight of the American border: the resulting majority of relatively short-haul transborder markets contrast sharply with transatlantic, transpacific, and even Latin American routes. Instead of a relatively few long-range routes, many much shorter markets bind the two countries together. In addition, the volume of the bilateral market for goods and services outpaces every other international market. It is not surprising that these characteristics have created a demand for transborder air services that dwarfs all other bilateral markets. It is the largest international passenger market in the world, and growing rapidly. For the United States, Canada is a bilateral market in a class by itself.

In arriving at our tentative decision here, we weighed the objections of both Northwest and Delta to a grant of antitrust immunity based on the fact that the underlying U.S.-Canada relationship lacks some attributes of a full comprehensive open-skies agreement, and the rebuttal by the Joint Applicants, which argues that the U.S.-Canada agreement contains all the essential elements of open-skies agreements.

While we agree with the arguments of both Northwest and Delta as a matter of principle, we view this application as a unique exception to that principle, given the very distinct character of the U.S.-Canada market. The U.S.-Canada transborder market supports more U.S. gateways, nonstop city-pairs, diverse airlines, and competitive routings and service options than any other international market. Perhaps most important, at the conclusion of the brief phase-in of entry and capacity at Montreal, Toronto, and Vancouver, the underlying air transport agreement between the United States and Canada will have created an open environment for transborder passenger and belly cargo services and prices. Against this background, we tentatively find that the U.S.-Canada aviation relationship justifies positive action on the application before us, to the extent described below.[16]

We note that DOJ has raised concerns about the potential loss of competition in some particular aspects of the New York-Toronto market. The applicants have agreed to conditions designed to address DOJ's concerns in this respect--*i.e.*, the applicants have agreed to exclude coordination of specified activities relating to certain types of fares and capacity for U.S. point-of-sale local passengers flying nonstop between New York and Toronto. We will adopt these conditions, which are set forth in Appendix A.

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[16] No other bilateral market resembles the U.S.-Canada market and, accordingly, we intend to continue to insist upon full open-skies agreements as a prerequisite to our consideration of applications for antitrust immunity.

In addition, we have tentatively decided to withhold approval and immunity from third-country markets and from all-cargo service. The U.S.-Canada aviation agreement does not provide for unrestricted all-cargo services, and does not permit unrestricted services or provide for operational flexibility in third-country markets. While we do not find, in the unique U.S.-Canada context, that these deficiencies compel a negative finding on the application as a whole, we will not grant to these alliance partners immunity for cooperative activity in areas where the underlying bilateral agreement does not provide soon for open entry and operational flexibility.

We will also require the applicants (1) to file all subsidiary and subsequent agreement(s) with the Department for prior approval;[17] and (2) to resubmit for renewal their various alliance agreement(s) in five years. We also find it in the public interest to direct CAI to report full-itinerary O&D Survey data for all passenger itineraries that contain a United States point (similar to the O&D data already reported by American).[18]

V. Decisional Standards under 49 U.S.C. Sections 41308 and 41309

A. Section 41308

Under 49 U.S.C. section 41308, the Department has the discretion to exempt a person affected by an agreement under section 41309 from the operation of the antitrust laws "to the extent necessary to allow the person to proceed with the transaction," provided that the Department determines that the exemption is required by the public interest. Generally, the Department withholds antitrust immunity from agreements that do not substantially reduce or eliminate competition,[19] *unless* there is a strong showing on the record that antitrust immunity is required by the public interest, and that the parties will not proceed with the transaction absent the antitrust immunity.[20]

B. Section 41309

Under 49 U.S.C. section 41309, the Department must determine, among other things, that an intercarrier agreement is not adverse to the public interest and not in violation of the statute before granting approval.[21] The Department may not approve an intercarrier agreement that *substantially* reduces or eliminates competition unless the agreement is necessary to meet a serious transportation need or to achieve important public benefits that cannot be met, and those benefits cannot be achieved,

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[17] Regarding this requirement, we do not expect the alliance partners to provide the Department with the minor technical understandings that are necessary to blend fully their day-to-day operations but that have no additional substantive significance. We do, however, expect and direct the joint applicants to provide the Department with any contractual instruments that may materially alter, modify, or amend the Commercial Alliance Agreement.

[18] We intend to use this data exclusively for purposes of monitoring the alliance. Accordingly, we will keep CAI's O&D data confidential. We will not release data for CAI to any other carrier. Correspondingly, CAI will not gain access to O&D data for any other carrier.

[19] *Investigation into the Competitive Marketing of Air Transportation--Agreement Phases*, Order 82-12-85, affirmed, *Republic Airlines Inc. v. C.A.B.*, 756 F.2d 1304 (8th Cir. 1985).

[20] *Pan American World Airways, Inc.*, Order 88-8-18 at 9; *Investigation into the Competitive Marketing of Air Transportation--Agreement Phases*, Order 82-12-85 at 124. *See* 14 C.F.R. §303.05(a) (contents of application for antitrust immunity).

[21] Section 41309(b).

by reasonably available alternatives that are materially less anticompetitive.[22] The public benefits include international comity and foreign policy considerations.[23]

The party opposing the agreement or request has the burden of proving that it substantially reduces or eliminates competition and that less anticompetitive alternatives are available.[24] On the other hand, the party defending the agreement or request has the burden of proving the transportation need or public benefits.[25]

VI. Tentative Approval of the Agreement

A. Excluded Services

It is the Department's policy not to approve and grant antitrust immunity to international inter-carrier cooperation agreements in markets that lack freedom of operation. Accordingly, we have tentatively determined to approve and grant immunity to the agreement, *except* for the following services and markets: (1) third-country (fifth- and sixth-freedom) markets; (2) all-cargo service; and (3) certain services relating to fares and capacity for particular categories of U.S. point-of-sale local passengers in the New York-Toronto market, as agreed between the applicants and the Department of Justice (DOJ).

1. Third-Country Fifth- and Sixth-Freedom Markets

The proposed alliance provides for coordination of services to third countries. Our analysis indicates that the alliance could provide new or additional on-line connecting service in over 3,000 city-pair markets from 168 U.S. cities to 20 cities beyond Canada. These markets accounted for 10.7 million O&D passengers during the 12 months ended September 1995.[26]

Notwithstanding the large potential traffic flows in the third-country markets, we tentatively conclude that we should deny approval and antitrust immunity to third-country markets, inasmuch as these markets are not open to code-sharing by competing carriers. Except for the U.S., the Canadian government's aviation agreements with other countries generally provide for only limited entry. Moreover, the U.S.-Canada aviation agreement does not provide for third-country code-sharing operations or for fifth-freedom rights. Even sixth-freedom operations are subject to a mandatory change of flight number at the homeland gateway. As a consequence, other U.S. carriers and alliances--

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22 Section 41309(b)(1)(A) and (B).
23 Section 41309(b)(1)(A).
24 Section 41309(c)(2).
25 *Id.*
26 Our analysis is based on Origin-Destination Survey of Airline Passenger Traffic for the twelve months ended September 1995, adjusted to account for traffic carried by non-reporting foreign airlines, based upon T-100 and T-100(f) international segment and market data (Data Banks 28-IS and 28-IM). We have determined that the public interest warrants our use of and limited disclosure of such data in this proceeding, because the public interest in evaluating this application on the basis of these data clearly outweighs any possible competitive disadvantage U.S. carriers might face from release of these data to foreign carriers. This determination is consistent with (1) the requirements set forth in sections 19-6(b) and 19-7(e) of 14 CFR Part 241 as they pertain to international T-100/T-100(f) data and O&D data, respectively, and (2) the Department's policy statement set forth in 14 CFR section 399.100, which provides that the Department may disclose restricted O&D data consistent with its regulatory functions and responsibilities.

either in partnership with other Canadian carriers or with third-country carriers--will have little opportunity to compete with the proposed alliance in these markets.

In view of the foregoing, we tentatively conclude that the restrictions applicable to third country markets are not consistent with our policy of granting antitrust immunity only in open competitive markets. Accordingly we have tentatively determined to deny approval and to withhold antitrust immunity from the alliance in third-country markets.[27] However, were Canada to agree to amend the U.S.-Canada aviation agreement to grant mutual fifth-freedom and third-country code-sharing rights, we would favorably consider extending immunity to third-country markets.

2. All-Cargo Services

The Joint Applicants also propose to coordinate and integrate their cargo service, including scheduling, pricing, and marketing. However, the new U.S.-Canada aviation agreement precludes co-terminalization in the other party's territory for all-cargo service (except in aircraft under 35,000 lbs.). This restriction effectively precludes the operation of all-cargo service making multiple stops in the other country's territory. The proposed alliance would be able to avoid this restriction through cooperative all-cargo operations, and as such would have significant competitive advantages over other airlines offering all-cargo service. Accordingly, we have tentatively determined to deny approval and withhold antitrust immunity for all-cargo services.[28] As with service to third countries, were the Canadian government to reconsider opening up all-cargo markets, we would give favorable consideration to request for approval and immunity for all-cargo service.

3. The New York-Toronto Market

The application by American and CAI for antitrust immunity requires us to examine the alliance's potential impact on competition in all relevant markets. On such antitrust issues, we initially confer with DOJ, given its experience in the enforcement of the antitrust laws. However, we have the ultimate authority to determine whether the application meets the statutory prerequisites for the grant of antitrust immunity.

DOJ has examined the likely competitive impact of the proposed alliance between American and CAI. DOJ identified one nonstop market--New York-Toronto--where it was concerned that competition could be reduced if American and CAI were authorized to agree on fares and capacity for local traffic. After discussions between the DOJ and the applicants, they have agreed to limit the scope of their requested immunity so as to exclude certain activities relating to particular fares and capacity for U.S. point-of-sale local passengers on the New York-Toronto route.

The conditions agreed upon by DOJ and the applicants are attached as Appendix A to this order. In brief, the agreement would exclude from the grant of immunity the following activities: pricing, inventory, or yield management coordination, or pooling of revenues, with respect to local U.S. point-

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[27] Our action here is in no way intended to revoke, amend, or otherwise alter American's and CAI's existing authority to offer code-share service in certain third-country markets. We do not, however, propose to grant antitrust immunity to their existing third-country code-share operations.

[28] Our withholding approval and immunity for all-cargo service does not apply to belly freight service on combination aircraft, where similar bilateral restrictions do not apply.

of-sale passengers flying nonstop between New York and Toronto, with certain exceptions. This agreement also provides for expiry of the limitations on the New York-Toronto market on February 25, 1998, upon the conclusion of the phase-in period at Toronto, unless DOJ notifies the parties that material changes in economic conditions warrant a review of such limitations.

The applicants have agreed to these limitations on the requested immunity after conferring with the DOJ, and we tentatively intend to include the agreed conditions in our proposed grant of antitrust immunity. The antitrust analysis that follows, therefore, reflects the exclusion from immunity of local traffic in the New York-Toronto market, to the extent set out in Appendix A.

We have carefully considered whether we should withhold our approval and grant of antitrust immunity for all alliance services to Montreal, Vancouver and Toronto, where short-term restrictions remain under the Agreement. We have tentatively concluded that despite our policy not to grant antitrust immunity in markets where there are restrictions on entry or flexibility of operations, the unique situation arising from the U.S.-Canada Agreement, as recited above, and the limited nature of the continuing restrictions, balanced against the very significant consumer competitive advantages that will arise from this alliance, justifies our grant of approval and immunity in these markets, notwithstanding the restrictions temporarily in effect.

First, we note that, with the exception of all-cargo services and third-country operations, the U.S.-Canada agreement currently provides for open transborder operations in all markets, with only a short transition period for these three markets alone.

In the Montreal and Vancouver markets, the agreement gave U.S. carriers a total of six new Montreal and six new Vancouver route opportunities, with up to two daily frequencies, in each of the two year phase-in period for these points, for a total of 24 new daily round trips at each city.[29] To date, the interest among U.S. carriers has not significantly exceeded the available route rights to Montreal or Vancouver. All restrictions on U.S.-flag entry into these cities expire in February 1997, shortly after, as a practical matter, the Joint Applicants can put the proposed alliance into effect, if approved. Therefore, considering the benefits of the alliance in these markets, the minimal remaining restrictions do not justify our withholding of approval and immunity for the very short period until all restrictions are removed.

We have had greater concern in the Toronto markets where the restrictions will remain until February, 1998. Moreover, unlike the Montreal and Vancouver markets, the U.S. carrier demand for Toronto route authority exceeds the authorizations under the Agreement.[30]

Nevertheless, considering that the alliance will not adversely affect competition to any significant degree (except in New York-Toronto, where the Justice Department agreed limitations will apply), and, in view of the unique nature of the U.S.-Canada market, we tentatively find it unnecessary to withhold approval and immunity in the Toronto markets. The alliance does not represent a significant increase in competitive concentration in any market. While American has a 43 percent share of the Chicago-

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[29] Montreal and Vancouver are still subject to the maximum of two daily flights per new designation, and a maximum of four daily flights per newly designated U.S. carrier in each market.

[30] The number of new route opportunities at Toronto so far has been limited to four twice-daily routes, with another four routes available in February 1997, a total of only eight routes over three years.

Toronto market, United has 35 percent, and Air Canada 17 percent. CAI has only a four percent share. Similarly, while CAI has a large percentage of the markets at Vancouver, resulting in the alliance being the largest operator in these markets, American's participation is relatively small.[31] We must recognize that CAI is a relatively small operator in the Canadian markets. This is to be contrasted with the other major Canadian carrier, Air Canada, which dominates the overall Montreal and Toronto markets.

Moreover, the alliance will continue to be subject to the restrictions on code shares applicable under the U.S.-Canada Agreement (Annex V, Section 4) at Toronto, Montreal and Vancouver. These restrictions limit the number of gateway-to-gateway transborder flights on which passengers carried to/from U.S. points beyond/behind the U.S. gateway may be carried, based on the number of new opportunities at those three Canadian gateway points available to U.S. carriers. Therefore, any competitive advantages that the alliance would gain in the short term in these restricted markets would be diminished to the extent these agreement restrictions limited cooperative code-share arrangements that the alliance could otherwise operate in these markets.

Most significantly, the Agreement, even for Toronto, currently provides certainty of the lifting of all the restrictions at these cities in only a brief period, during which no competitive harm from the alliance can be foreseen.

Considering all these factors together, and the overwhelming consumer benefits to be derived from the alliance during this period, we are tentatively persuaded that under these unique circumstances the public interest does not require that we withhold approval and immunity for operations in these temporarily restricted markets.

To reiterate, our tentative decision to afford antitrust immunity, prior to the complete *de jure* opening of the Toronto market, is based on a determination that delaying the effectiveness of immunity would serve no significant public interest purpose. First, we anticipate that the four new U.S. carrier designations made available in February 1997 will satisfy most U.S. carrier requests to serve that market, and that, except with respect to the New York-Toronto market, the market will effectively be open during the interim period before *de jure* open skies. Second, we rely on the fact that under the U.S.-Canada bilateral, an open transborder aviation environment will become effective automatically, without any further action by any government entity in February, 1998. Absent this near-term satisfaction of entry needs and the certainty of complete entry liberalization in so short a period, we would not grant immunity for the U.S.-Toronto routes. Moreover, we note that Air Canada has a 41.2 percent market share of transborder passengers at Toronto.[32] We would not want to harm competition by artificially delaying the competitive entry of a strong alliance. These factors are relevant to our decision to accelerate the grant of antitrust immunity in this case and not to allow by inaction a result that is less competitive.

We emphasize that our tentative decision to afford immunity for the non-New York-Toronto routes should in no way be interpreted to suggest any relaxation of our policy regarding antitrust immunity.

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[31] At Vancouver, American's share of nonstop and single-plane passengers was less than nine percent and CAI's was less than 25 percent for an alliance total of about 33 percent. United carried 24 percent of nonstop and single-plane passengers, Delta about 15 percent, Alaska/Horizon ten percent, and Northwest six percent. Several other carriers (including Air Canada) have market shares between one and four percent.

[32] Combined Transborder Origin-Destination Survey (Data Bank 9), 12 months ended September 1995.

Rather, our decision is premised on the uniqueness of the Canadian case, not only for the reasons noted above, but also because of Canada's unique geographic relationship with the United States, and the vast and various networks of land transportation alternatives available between the U.S. and Canada, a competition force absent in transoceanic markets. Absent all of these factors, the Department would not be favorably disposed to providing immunity to the U.S.-Toronto routes prior to February, 1998. We are aware of no present or potential situation in Europe or elsewhere that presents the many extraordinary factors in the Canadian case, and on which we rely here, to afford a grant of immunity during a short-term phase-in period.

Our policy remains to consider the grant of antitrust immunity only where the market(s) at issue are currently specified to be fully open to new entry and operations -- both *de jure* (by reason of bilateral agreements) and *de facto*. Only in such markets can we be assured that immunity will be pro-competitive and pro-consumer, the touchstones of our immunity approach. Moreover, it must be clearly understood that the existence of an open skies relationship in no way "guarantees" any grant of immunity. To the contrary, it is entirely possible that immunity will not be found to be pro-competitive or pro-consumer in particular cases notwithstanding a fully open national market, depending on such factors as relevant market concentration, potential future barriers, overall dominance and size of the applicants, and the like. In short, an open skies agreement, even where it is also a *de facto* open entry market, is a necessary, but not automatically sufficient, basis for the grant of antitrust immunity.

B. Antitrust Issues

The Joint Applicants state that through the Alliance Agreement they intend to broaden and deepen their cooperation in order to improve efficiency, expand various benefits available to the traveling and shipping public, and enhance their ability to compete in the global marketplace. They state that, while retaining their separate corporate and national identities, they fully intend to cooperate to the extent necessary to create a seamless air transport system. Accordingly, the Alliance Agreement's intended commercial and business effects are equivalent to a merger of the two airlines. In determining whether the proposed transaction would violate the antitrust laws, we will apply the standard Clayton Act test used in examining whether mergers will substantially reduce competition in any relevant market.[33]

The Clayton Act test requires the Department to consider whether the Agreement will substantially reduce competition by eliminating actual or potential competition between American and CAI so that they would be able to effect supra-competitive pricing or reduce service below competitive levels.[34] To determine whether a merger or comparable transaction is likely to violate the Clayton Act, the Department of Justice (DOJ) and the Federal Trade Commission (FTC) use their published merger guidelines.[35] The Merger Guidelines' general approach is that transactions should be blocked if they are likely to create or enhance market power, market power being defined as the ability profitably to maintain prices above competitive levels for a significant period of time (firms with market power can also harm customers by reducing product and service quality below competitive levels). To determine whether a proposed merger is likely to create or enhance market power, the Department of Justice and the FTC primarily consider whether the merger would significantly increase concentration in the

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33 Order 92-11-27 at 13.

34 *Id.*

35 57 Fed. Reg. 41552 (September 10, 1992).

relevant markets, whether the merger raises concern about potential competitive effects in light of concentration in the market and other factors, and whether entry into the market would be timely, likely, and sufficient either to deter or to counteract the merger's potential for harm.

1. Transborder Competition

The traditional analysis for airline mergers has focused on discrete city-pair routes. Without minimizing the significance of city-pair analysis, however, we believe it also important to recognize that the rapid growth and development of international airline alliance networks requires an additional perspective on competitive impact -- the perspective of more broadly defined open aviation markets (in this case, the U.S.-Canada transborder market) in which travelers have multiple competing options for reaching destinations over multiple intermediate points. The pro-competitive effects of such alliances can be particularly evident in the case of markets between points lying behind the U.S. gateway and points lying beyond the Canadian gateway, where integrated alliances with coordinated connections, marketing, and services, can offer competition well beyond mere interlining. The competitive effect is evident, though perhaps less dramatic than in transatlantic markets, in the case of services between interior U.S. cities and Canadian gateways, or between U.S. gateways and interior Canadian cities. These types of alliances, as a result of their increased operational integration, can better offer a multitude of attractive new on-line services to thousands of U.S.-Canada transborder city-pair markets. Thus, a significant element in antitrust analysis is the extent to which facilitating airline integration (through antitrust immunity or otherwise) can enhance overall competitive conditions.

Our analysis indicates that this alliance will have a strong pro-competitive impact, bringing on-line service to nearly 20,000 transborder city-pair markets with an estimated traffic of over 9 million passengers. In particular, the alliance will significantly increase competition and service opportunities for many of the 4 million U.S.-Canada passengers in behind-U.S. gateway and beyond-Canadian gateway markets.[36] This analysis further supports our belief that these alliances will benefit consumers by increasing U.S.-Canada service options and enhancing competition between airlines, particularly for traffic to or from cities behind or beyond major gateways for transborder service. U.S. consumers and airlines should be major beneficiaries of this expansion and the associated increase in service opportunities.

With this perspective, we address below the issue of airline competition at the city-pair market level. In doing so, we note that concentration figures are not conclusive. Individual airline nonstop city-pair markets usually have high levels of concentration, since most nonstop markets are served by only a few airlines. A key consideration for determining whether the American-CAI alliance (or any other airline merger or joint venture) is likely to reduce competition is potential competition, *i.e.*, whether other airlines can enter the relevant markets in response to inadequate service or supra-competitive prices. The new aviation agreement with Canada will soon eliminate all governmental restrictions on entry into U.S.-Canada transborder markets for U.S. and Canadian airlines. The agreement will accordingly eliminate the most significant barrier to entry in those markets. The relevant considerations here, then, are whether other factors will prevent U.S. and foreign airlines from entering U.S.-Canada markets, should the applicants increase fares above, or lower service below, competitive levels.

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[36] Combined Transborder Origin-Destination Survey (Data Bank 9), 12 months ended September 1995.

Finally, as a general rule, airlines like other firms may engage in joint ventures and cooperative arrangements without violating the antitrust laws. The courts and the enforcement agencies have usually found that such arrangements are likely to promote economic efficiency and further competition.[37] As discussed above, that has been our experience with the Northwest/KLM alliance--the integration of those partners' operations has increased the efficiency of their operations and made it possible for the two carriers to offer improved service.

The Joint Applicants primarily compete in transborder markets. The current code-share arrangements between the Joint Applicants involve nine gateway-to-gateway nonstop transborder routes, several one-stop transborder routes, and certain routes to third countries.[38]

2. Particular Markets

In addition to considerations of general transborder airline network competition (and after excluding all-cargo services, and third-country, fifth- and sixth-freedom markets), there are three relevant types of markets requiring a competitive analysis: first, the aggregate U.S.-Canada market; second, the individual city-pair markets; and last, the behind- and beyond-gateway transborder markets.

(a) The U.S.-Canada Market

We have tentatively determined that the Alliance Agreements, as conditioned, will not significantly reduce competition in the aggregate U.S.-Canada transborder market. During calendar year 1995, our analysis shows that American's U.S.-Canada scheduled nonstop passenger share was 16.7 percent, and CAI's scheduled nonstop passenger share was 7.8 percent (the airlines combined share of the market was 24.5 percent). In contrast, Air Canada alone had a 25.7 percent share. In addition, Delta had a 12.9 percent share of the overall U.S.-Canada market, Northwest 10.6 percent, United 9.2 percent, and USAir 7.2 percent. In addition, several other U.S. and Canadian carriers had market shares between 0.5 percent and 2.8 percent.[39]

Similarly, during the 12 months ended September 1995, American's share of true U.S.-Canada Origin-Destination (O&D) passengers was 16.9 percent, and CAI's was 4.9 percent, for total market share of 21.9 percent. Air Canada had a 26.7 percent share of O&D passengers, Delta 16.0 percent, Northwest 11.9 percent, United 10.1 percent, and USAir 8.1 percent. A number of other carriers had market shares between 0.1 percent and 2.0 percent.

The new U.S.-Canada aviation agreement has resulted in large growth of new transborder service. As of December 1995, U.S. and Canadian carriers had initiated scheduled nonstop service in 45 previously unserved markets (12 by U.S. carriers, 27 by Canadian carriers, and six by both U.S. and Canadian

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[37] *See, e.g., Northwest Wholesale Stationers v. Pacific Stationery & Printing Co.*, 472 U.S. 284, 295 (1985).

[38] American and CAI hold authority to code-share in the following markets: Chicago-Calgary/Winnipeg/Ottawa/Toronto/Montreal; Dallas/Ft. Worth-Toronto/Montreal/Vancouver/Calgary; Miami-Toronto/Montreal; New York-Toronto/Montreal; San Jose-Vancouver; Honolulu-Vancouver; Los Angeles/San Francisco-Hong Kong; various U.S. points-Taiwan; Los Angeles-Guadalajara/San Salvador/San Jose, Costa Rica; Chicago-Manchester/Birmingham, UK; Calgary/Winnipeg/Ottawa/Toronto/Montreal/Vancouver-87 interior Canadian points; and Chicago/Dallas/Ft. Worth/Miami/New York/San Jose-176 interior U.S. points.

[39] T-100 and T-100(f) nonstop segment data (Data Bank 28-IS).

carriers), and new competitive scheduled service was instituted in another 14 nonstop markets. Fourteen new U.S. cities and one new Canadian city now receive scheduled nonstop transborder service. Altogether, in December 1995, there were 90 transborder markets receiving scheduled service, compared to only 53 a year earlier, a 70 percent increase. As a consequence of these new services, transborder traffic and capacity skyrocketed. U.S.-Canada nonstop passengers in December 1995 grew 28 percent from December 1994, while nonstop flights grew by 45 percent.[40]

This growth can be directly attributed to the new bilateral agreement's elimination of governmental restraints on entry in the U.S.-Canada transborder market. Accordingly, except as elsewhere provided, we tentatively conclude that the Joint Applicants will be unable to raise prices above (or reduce service below) competitive levels in the overall U.S.-Canada market without attracting new competition, and that, as a consequence, the overall U.S.-Canada marketplace is highly competitive, both as to nonstop and connecting service options.

(b) The City-Pair Markets

The second category of relevant market consists of the two city-pair markets served nonstop by both applicants (Chicago-Toronto and New York/Newark-Toronto) and the other city-pairs served by the applicants under their current code-share agreement.[41] However, the applicants have undertaken to exclude from the scope of requested immunity capacity, fares, and yield management decisions for certain categories of U.S.-source local passengers in the New York-Toronto market.

American is the largest carrier in the Chicago-Toronto market, with about 43 percent of the nonstop and single-plane traffic during Calendar Year 1995, closely followed by United with about 35 percent of nonstop and single-plane traffic. Air Canada's 1995 share was about 17 percent, and CAI's about four percent. Together, the proposed alliance had about a 47 percent market share in 1995.[42]

In the New York-Toronto market, Air Canada had over 60 percent of nonstop and single-plane passengers, compared to only about 29 percent for American and less than 10 percent for CAI. Together, the proposed alliance had less than a 39 percent market share in 1995.

Apart from U.S. point-of-sale nonstop passengers in the New York-Toronto market, for which the carriers would not be immunized under the conditions to which they have agreed with DOJ, we conclude that the alliance is unlikely to cause a significant reduction in competition in the Chicago/New York-Toronto markets. Neither American nor CAI is the dominant hub carrier at any of the three cities involved. Moreover, the alliance will continue to face significant nonstop competition from one or more dominant hub carriers in both markets.[43] We believe this direct competition in the two nonstop

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[40] *Id.*

[41] The Department has tentatively taken the view that, for a large number of travelers in long-haul markets not constrained by strict time-sensitivity, one-stop and connecting service can provide a reasonable substitute for nonstop service and should be considered as a competitive option for purposes of antitrust analysis. (Order 96-5-12 at 23 n.50.)

[42] T-100 and T-100(f) data (Data Banks 28-IS and 28-IM).

[43] The Chicago-Toronto route is served nonstop by United, which has its largest hub at Chicago, and which is the principal hubbing carrier at Chicago O'Hare with 45 percent of enplanements in 1995 and 39 percent of departures. (American's hub at Chicago is somewhat smaller, with 34 percent of enplanements and 31 percent of departures). The Chicago-Toronto market is also served by Air Canada, which has its principal hub at Toronto, where it is the dominant

markets, together with competition from connecting services offered by other carriers and the threat of new entry (beginning shortly at Montreal, Vancouver, and Toronto), will adequately prevent the alliance from increasing fares above or reducing service below competitive levels.

Similarly, except for the short-term phase-in limitations on U.S.-flag entry at Montreal, Toronto, and Vancouver, there are no barriers to entry in any of the other transborder code-sharing markets. Accordingly, we also tentatively conclude that the alliance will not significantly detract from competition in any of the alliance's other existing transborder code-sharing passenger markets.

(c) The Behind- and Beyond-Gateway Transborder Markets

As we have noted, the pro-competitive effects of global alliances can be particularly evident in the case of the behind- and beyond-gateway markets, where many passengers now lack convenient on-line service, and where integrated alliances with coordinated connections, marketing, and services can, therefore, offer competition well beyond traditional interlining. For example, our analysis estimates that the proposed alliance would result in enhanced on-line connecting opportunities in nearly 20,000 city-pair markets from 168 U.S. cities to 117 cities in Canada. These markets accounted for over 9 million transborder O&D passengers during the 12 months ended September 1995. Of these, over 4.2 million passengers were in behind-U.S. gateway or beyond-Canadian gateway transborder markets.[44]

Accordingly, we tentatively conclude that the proposed alliance will significantly increase competition in the behind- and beyond-gateway U.S.-Canada markets.

Except as provided above, we tentatively find that the Agreement will substantially benefit competition, subject to the conditions stated by this order, since it will enable the Joint Applicants to operate more efficiently, provide the public with a wider variety of on-line services, and permit American and CAI to compete more effectively with other transborder alliances. Therefore, we tentatively find that the proposed Alliance Agreement, as conditioned, will not cause a substantial reduction or elimination of competition.

C. Public Interest Issues

Under section 41309 we must determine whether the Alliance Agreement would be adverse to the public interest. A similar public interest examination is required by section 41308. Except as noted, we tentatively find that approval of the Alliance Agreement will promote the public interest.

Subject to the phase-in provisions for Montreal, Toronto, and Vancouver, which soon expire, the open transborder agreement with Canada gives any authorized carrier from either country the ability to serve any route between the two countries (including open intermediate and beyond transborder rights) if it so wishes. With the exceptions noted, the agreement places no limits on the number of flights that can be operated, and carriers can charge any fare unless it is disapproved by both countries.

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hub carrier, with over 40 percent of U.S.-bound enplanements and departures in 1995. (As noted above, Air Canada is also the largest carrier in the overall U.S.-Canada market.) The New York-Toronto market also receives nonstop service from Air Canada, which is the dominant carrier in the market, with over 60 percent of market passengers, enplanements, and departures in 1995. (SOURCE: T-100 and T-100(f) data.)

[44] Combined Transborder Origin-Destination Survey for the 12 months ended September 1995.

Except as provided above with respect to all-cargo services, third-country fifth- and sixth-freedom markets, and the New York-Toronto market, we have tentatively found that the Agreement is likely to benefit the traveling public in numerous markets and is unlikely materially to reduce competition.

In this case, having tentatively determined that the overall competitive effect of the Alliance Agreement is beneficial and consistent with our international aviation policy, we believe that the public interest favors approval of the agreement and the grant of antitrust immunity. In so stating, of course, we will continue to monitor closely the effects of an immunized alliance on consumers and on competition, to ensure that the immunized alliance continues to serve the public interest, and will review the entire agreement in five years.

VII. Tentative Grant of Antitrust Immunity

We have the discretion to grant antitrust immunity to agreements approved by us under section 41309 if we find that the immunity is required by the public interest. It is not our policy to confer antitrust immunity simply on the grounds that an agreement does not violate the antitrust laws. We are willing, however, to grant immunity if the parties to such an agreement would not otherwise go forward, and if we find that grant of antitrust immunity is required by the public interest.

American and CAI have stated that they are unlikely to proceed with the Alliance Agreement without antitrust immunity. We agree. The Joint Applicants maintain that the public benefits that the airlines seek to achieve through the formation of an expanded alliance cannot be accomplished absent antitrust immunity. They claim that the proposed integration of services will assuredly expose them to antitrust risk, since they fully intend to establish a common financial objective, permitting them to compete more effectively with other strategic alliances. Additionally, it is particularly true, as they point out, that full operational integration will necessarily mean that they will coordinate all of their U.S.-Canada business activities, including scheduling, route planning, pricing, marketing, sales, and inventory control.

Since the antitrust laws allow competitors to engage in joint ventures that are pro-competitive, we think it unlikely that the integration of the applicants' services in the manner here approved would be found to violate the antitrust laws.[45] Nevertheless, since the applicants will ultimately be ending their competitive service in some markets, they could be subjected to extensive and burdensome antitrust litigation if we did not grant immunity.

To the extent discussed above, we tentatively find that antitrust immunity should be granted to the Alliance Agreement. We also intend to review and monitor the applicants' progress in implementing the Agreement, if we decide to approve and immunize it, to ensure that the applicants are carrying out the Agreement's pro-competitive aims. We also propose to require the Joint Applicants to resubmit the Agreement for review in five years, if we make final this tentative decision to approve and immunize it.

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[45] Cooperative arrangements between airlines are today commonplace. We are unaware of any holding that such arrangements violate the antitrust laws. Order 92-11-27 at 19.

VIII. IATA Tariff Coordination Issue

We have tentatively decided not to condition our grant of antitrust immunity to the Alliance upon the withdrawal by the Joint Applicants from IATA tariff coordination activities.[46] We believe that this condition is unnecessary for a number of reasons. American does not participate in IATA passenger tariff conferences. In addition, we propose to limit our grant of immunity in this case to transborder U.S.-Canada markets. Since there is no IATA traffic conference for U.S.-Canada markets, the proposed alliance, as conditioned, raises no prospects of the overlapping "dual" immunity that troubled us in the United/Lufthansa and Delta/Austrian/Sabena/Swissair alliances, and we see no need here to impose any conditions on IATA participation.

In the event, however, that future talks between the Governments of the United States and Canada result in further liberalization of the U.S.-Canada aviation agreement to provide for open fifth- and sixth-freedom route rights and third-country code-shares, we would expect to impose limitations (similar to those we recently adopted in the United/Lufthansa case, Order 96-5-27) on the alliance's participation in IATA tariff conferences as a condition for granting immunity to third-country code-share operations.

IX. O&D Survey Data Reporting Requirement[47]

We have access to market data where our carriers operate, including markets that they serve jointly with foreign airlines, for example, the Department's Origin-Destination Survey of Airline Passenger Traffic (O&D Survey). We have also collected special O&D Survey code-share reports for three large alliances, and have directed all other U.S. airlines to file reports for their transatlantic code-share operations beginning with the second quarter of 1996.

However, we receive no market information for passengers traveling to or from the U.S. when their entire trip is on foreign airlines, except for T-100f data for nonstop and single-plane markets. Such passengers account for a substantial portion of all O&D traffic between the U.S. and foreign cities, and the absence of such information severely handicaps our ability to evaluate the economic and competitive consequences of the decisions we must make.

In addition to the added importance of our decision-making regarding international issues, we must also ensure that our grant of antitrust immunity does not lead to anticompetitive consequences. We have therefore tentatively decided to require foreign airline partners of our carriers in alliances with antitrust immunity to report full-itinerary Origin-Destination Survey of Airline Passenger Traffic for all passenger itineraries that contain a United States point (similar to the O&D Survey data already reported by American).[48]

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[46] We have previously determined to place such conditions on IATA tariff coordination on the United-Lufthansa alliance in Order 96-5-27, and tentatively placed such conditions on the Delta-Austrian-Sabena-Swissair alliance in Order 96-5-26.

[47] We intend to provide confidentiality protection for this data, as we do for international data submitted by U.S. airlines. As we intend to use this data for internal monitoring purposes, we do not intend to release it to any other airlines, to avoid competitive problems.

[48] We intend to request other foreign carrier members of international alliances involving U.S. carriers to submit O&D Survey data and we intend to condition any further grants or renewals of antitrust immunity on provision of such data.

We note that CAI already reports this data to the Canadian government, which, pursuant to an informal intergovernmental agreement between the Department of Transportation and the Canadian Ministry of Transport, exchanges U.S.-Canada O&D data with the Department. As a practical result, therefore, CAI is already indirectly providing us with this data. Under the current system, however, CAI is under no obligation to the Department to provide us with this data, and we lack ability to force CAI to report this data. By requiring CAI to file directly, we will have the ability to enforce CAI's compliance to provide timely, accurate data.

To further ensure that our grant of antitrust immunity does not lead to anticompetitive consequences, we have decided to grant confidentiality to CAI's Origin-Destination report and special report on code-share passengers. Currently, we grant confidential treatment to international Origin-Destination data. We provide these data confidential treatment because of the potentially damaging competitive impact on U.S. airlines and the potential adverse effect upon the public interest that would result from unilateral disclosure of these data (data covering the operations of foreign air carriers that are similar to the information collected in the Passenger O&D Survey are generally not available to the Department, to U.S. airlines, or to other U.S. interests).

14 C.F.R. Part 241, section 19-7(d)(1) provides for disclosure of international Origin-Destination data to air carriers directly participating in and contributing to the O&D Survey. While we have found it appropriate to direct CAI to provide certain limited Origin-Destination data to the O&D Survey, we have determined that CAI is not an air carrier within the meaning of Part 241. 14 C.F.R. Part 241, section 3 defines an air carrier as "[a]ny citizen of the United States who undertakes, whether directly or indirectly or by a lease or any other arrangement, to engage in air transportation." CAI accordingly will have no access to the data filed by U.S. air carriers. Moreover, we are making CAI's submissions confidential while maintaining the current restriction on access to U.S. air carrier Origin-Destination data by foreign air carriers.

X. Operation under a Common Name/Consumer Issues

Since operation of the Alliance Agreement could raise important consumer issues and "holding out" questions, if the Joint Applicants choose to operate under a common name or use "common brands," they will have to seek separate approval from the Department prior to such operations. For example, it is Department policy to consider the use of a single air carrier designator code by two or more carriers to be unfair and deceptive and in violation of the Act unless the airlines give reasonable and timely notice of its existence.[49]

XI. Summary

We tentatively conclude that granting the application for approval and antitrust immunity for the Commercial Alliance Agreement will benefit the public interest by enhancing service options available to travelers, benefiting U.S. consumers, and encouraging a further liberalization of the transborder and global marketplace. We believe that the Alliance Agreement will strengthen competition in the markets that the applicants serve, since it will enable them to offer better service and to operate more efficiently. Furthermore, we expect that the Alliance Agreement and the proposed integration of the airlines

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[49] *See* 14 C.F.R. §399.88.

operations will strengthen American's ability to compete effectively against existing alliances and against Air Canada.

We tentatively conclude that our grant of approval and antitrust immunity to the Commercial Alliance Agreement should be conditioned, as set forth in this order. We also tentatively direct American and CAI to resubmit the pertinent Alliance Agreement five years from the date of the issuance of the final order in this case. However, the Department is not authorizing the Joint Applicants to operate under a common name or use common brands. If the Joint Applicants wish to operate under a common name or brands, they will have to comply with our relevant procedures before implementing the change.

In addition, to the extent not otherwise limited by our conditions and limitations, we tentatively limit and condition, as delineated in subparagraphs (a), (b), and (c) to Ordering Paragraph 1 and in Appendix A of this order, the Joint Applicants' request regarding their proposed integration of services and operations between points in the United States and Canada. We also tentatively direct the Joint Applicants to file all subsidiary and/or subsequent agreement(s) with the Department for prior approval, and we tentatively direct CAI to report full-itinerary Origin-Destination Survey of Airline Passenger Traffic for all passenger itineraries that contain a United States point (similar to the O&D Survey data already reported by American).

ACCORDINGLY:

1. We direct all interested persons to show cause why we should not issue an order making final our tentative findings and conclusions, granting approval and antitrust immunity to the Commercial Alliance Agreement between American Airlines, Inc. and Canadian Airlines International Ltd., subject to the proposed limits and conditions as set forth in (a), (b), and (c) below;

(a) The approval and immunity granted in this proceeding shall not apply to operations involving all-cargo services or to operations involving services to or from third countries;

(b) The Joint Applicants shall not operate or hold out service under a common name or brands without obtaining prior approval from the Department; and

(c) The approval and immunity granted in this proceeding is further subject to the terms, limitations, and conditions set forth in Appendix A hereto.

2. We tentatively direct American Airlines, Inc. and Canadian Airlines International Ltd. to resubmit their Commercial Alliance Agreement five years from the date of issuance of the final order in this case;

3. We tentatively direct Canadian Airlines International Ltd. to report full-itinerary Origin-Destination Survey of Airline Passenger Traffic data for all passenger itineraries that include a United States point (similar to the O&D Survey data already reported by its alliance partner American Airlines, Inc.);

4. We tentatively direct American Airlines, Inc. and Canadian Airlines International Ltd. to submit any subsequent subsidiary agreement(s) implementing the Expansion Agreement for prior approval;[50]

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[50] *See* footnote 16, *supra.*

5. We direct American Airlines, Inc. and Canadian Airlines International Ltd. to file a signed and dated copy of the Agreement within three calendar days from service of this order;

6. We direct interested persons wishing to comment on our tentative findings and conclusions, or objecting to the issuance of the order described in ordering paragraphs 1-4 to file an original and five copies in Docket OST-95-792, and serve on all persons on the service list in that docket, a statement of such objections or comments, together with any supporting evidence the commenter wishes the Department to notice, by June 4, 1996. Answers to objections shall be due no later than June 7, 1996;[51]

7. If timely and properly supported objections are filed, we will afford full consideration to the matters or issues raised by the objections before we take further action. If no objections are filed, we will deem all further procedural steps to have been waived;

8. We dismiss the motion of United Air Lines, Inc. to defer consideration of the application;

9. We grant the joint motion of American Airlines, Inc. and Canadian Airlines International Ltd. to file unauthorized documents; and

10. We shall serve this order on all persons on the service list in this docket.

By:

CHARLES A. HUNNICUTT
Assistant Secretary for Aviation
and International Affairs

(SEAL)

An electronic version of this document
will be made available on the World Wide Web at:
http://www.dot.gov/dotinfo/general/orders/aviation.html

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[51] Because of the expedited schedule of this proceeding, service should be by hand delivery or FAX. The original filing should be on 8½" by 11" white paper using dark ink and be unbound without tabs, which will expedite use of our docket imaging system.

The following conditions were agreed to by the Department of Justice and American Airlines, Inc.

CONDITIONS PROPOSED BY THE DEPARTMENT OF JUSTICE AND AMERICAN AIRLINES, INC. GOVERNING THE ANTITRUST IMMUNITY FOR THE COMMERCIAL ALLIANCE AGREEMENT BETWEEN AMERICAN AIR LINES, INC. AND CANADIAN AIRLINES, LTD.

Grant of Immunity

The Department grants immunity from the antitrust laws to American Air Lines, Inc. and Canadian Airlines, Ltd., and their affiliates, for the Commercial Alliance Agreement dated November 2, 1995 between American and Canadian and for any agreement incorporated in or pursuant to the Commercial Alliance Agreement.

Limitations on Immunity

The foregoing grant of antitrust immunity shall not extend to the following activities by the parties: pricing, inventory or yield management coordination, or pooling of revenues, with respect to local U.S. point-of-sale passengers flying nonstop between New York and Toronto or provision by one party to the other of more information concerning current or prospective fares or seat availability for such passengers than it makes available to airlines and travel agents generally.

Exceptions to Limitations on Immunity

Despite the foregoing limitations, antitrust immunity shall extend to the joint development, promotion or sale by the parties of the following discounted fare products with respect to local U.S. point-or-sale passengers flying nonstop between New York and Toronto: corporate fare products, consolidator-wholesaler fare products, promotional fare products; group fare products; and fares and bids for government travel or other traffic that either party is prohibited by law from carrying on services offered under its own code. For immunity to apply, however: (i) in the case of corporate fare products and group fare products, local U.S. point-of-sale non-stop New York -Toronto traffic shall constitute no more than 25% of a corporation's or group's anticipated travel (measured in flight segments) under its contract with American and Canadian: and (ii) in the case of consolidator/wholesaler fare products and promotional fare products, the fare products must include similar fares for travel in at least 25 city pairs in addition to New York - Toronto. Antitrust immunity shall also extend to the following: joint cargo programs, frequent flyer programs, joint travel agency commission and override programs, combined AAirpass program, and standard system-wide terms and charges for ancillary passenger services.

Definitions for purpose of this order

"Corporate fare products" means the offer of non-published fares at discounts from the otherwise applicable tariff prices to corporations or other entities for authorized travel, which discounts may be stated as percentage discounts from specified published fares, net prices, volume discounts, or other forms of discount.

"Consolidator/wholesaler fare products" means the offer of non-publishes fares at discounts from the otherwise applicable tariff prices to (i) consolidators for sale by such consolidators to members of the general public either directly, or through travel agents or other intermediaries, at prices to be decided by the consolidator, or (ii) wholesalers for sale by such wholesalers as part of tour packages in which air travel is bundled with other travel products, which discounts, in either case, may be stated either as net prices due the parties on sales by such consolidator or wholesaler, or as percentage commissions due the consolidator or wholesaler on such sales.

"Promotional fare products" means published fares that offer directly to the general public for a limited time discounts from previously published fares having similar travel restrictions.

"Group fare products" means the offer of non-published fares at discounts from the otherwise applicable tariff prices for the members of an organization or group to travel from multiple origination points to a single destination to attend an identified special event, which discounts may be stated either as percentage discounts from specified published fares or net prices.

Clarification of scope of limitations on immunity

Under no circumstances shall the limitations on antitrust immunity set forth above be construed to limit the parties' antitrust immunity for activities jointly undertaken pursuant to the Alliance Agreement other than as specifically enumerated. Immunized activities include, without limitation: decisions by the parties regarding the total number of frequencies and types of aircraft to operate on the New York - Toronto route and the configuration of such aircraft; coordination of pricing, inventory and yield management, and pooling of revenues, with respect to non-local passengers traveling on nonstop flights on the New York - Toronto route; and the provision by one party to the other of access to its internal reservations system for use exclusively in checking-in passengers or making sales to the general public at ticketing facilities.

Expiration of Limitations on Immunity

The limitations on immunity described above shall expire on February 25, 1998, upon the conclusion of the phase-in period at Toronto, as described in the U.S.-Canada Air Transport Agreement, unless at that time, the Justice Department notifies the parties that material changes in economic conditions (which could include an absence or delay

in expected new entry into the market) warrant a review of such limitations. Nothing herein shall prohibit the parties from requesting that the Department review the limitations on antitrust immunity set forth above to determine whether they should be discontinued or modified in light of changed competitive conditions prior to February 25, 1998.